A Report
to the
Montana
Legislature

Financial-Compliance Audit

Department of Natural Resources and Conservation

For the Two Fiscal Years Ended June 30, 2008

October 2008

Legislative Audit
Division

08-17

Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

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October 2008

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Natural Resources and Conservation for the two fiscal years ending June 30, 2008. The report contains an unqualified opinion on the department's financial schedules. Included in this report are 17 recommendations primarily related to internal controls, financial activities related to fires, trust land administration, and compliance with state law. This report also contains two disclosure issues related to meal reimbursement and leases of trust lands.

The department's written response to the audit recommendations is included in the audit report at page B-3. We thank the director and her staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

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Elected, Appointed, and Administrative Officials

Administrative Officials	Mary Sexton, Director
	Joe Lamson, Deputy Director
	Ann Bauchman, Centralized Services Division Administrator
	Ray Beck, Conservation and Resource Development Division Administrator
	Bob Harrington, Forestry Division Administrator
	Tom Richmond, Oil and Gas Conservation Division Administrator
	John Tubbs, Water Resources Division Administrator
	Susan Cottingham, Reserved Water Rights Compact Commission Program Manager
	Tom Schultz, Trust Land Management Division Administrator
	Candace F. West, Chief Legal Counsel
State Board of Land Commissioners	Brian Schweitzer, Governor
	John Morrison, State Auditor
	Brad Johnson, Secretary of State
	Linda McCulloch, Superintendent of Public Instruction
	Mike McGrath, Attorney General
Administratively Attached Boards, Commissions & Committees	Board of Water Well Contractors
	Board of Oil and Gas Conservation
	Reserved Water Rights Compact Commission
	Rangeland Resources Committee
	Drought Advisory Committee
	Resource Conservation Advisory Council
	Montana Grass Conservation Commission
	Flathead Basin Commission

Report Summary

Department of Natural Resources and Conservation

This report documents the results of our financial-compliance audit of the Department of Natural Resources and Conservation (department) for the two fiscal years ended June 30, 2008. We issued an unqualified opinion on the financial schedules contained in the report. This means the reader may rely on the financial information presented and the supporting accounting records.

This report contains 17 recommendations. The recommendations are related to internal controls, financial activities related to fires, trust land administration, and compliance with state law. This report also contains two disclosure issues related to meal reimbursement and leases of trust lands. The previous report contained eight recommendations to the department. The department implemented three, partially implemented three, and did not implement two of the recommendations.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana Department of Natural Resources and Conservation (department) for the two fiscal years ended June 30, 2008.

The objectives of this audit were to:

1. Determine whether the department complied with selected state and federal laws and regulations.
2. Obtain an understanding of the department's control systems to the extent necessary to support our audit of the department's financial schedules, and if appropriate, make recommendations for improvement in management and internal controls of the department.
3. Determine whether the department's financial schedules present fairly the results of operations for the two fiscal years ended June 30, 2008.
4. Determine the status of prior audit recommendations.

Auditing standards require us to communicate, in writing, control deficiencies we identified as a result of audit objective #2 above and considered to be significant or material. A control deficiency exists when the design or operation of a control does not allow management or employees to prevent or detect misstatements on a timely basis. A significant deficiency is one or more control deficiencies that affects management's ability to accurately process transactions. A material weakness is one or more significant deficiencies that adversely affect management's ability to fairly present its financial schedules.

Table 1 below outlines the status of significant deficiencies and material weaknesses we identified during this audit.

Table 1
Summary of Control Deficiencies

Subject	Significant Deficiency	Material Weakness	Page
Internal Controls	Yes	Yes	7
Procurement Procedures	Yes	No	11
Unsupported Charges	Yes	No	12
Meal Reimbursement Rates	Yes	No	13
Accounting for Land Banking Transactions	Yes	No	21
Revenue Recognition	Yes	Yes	26

This report contains 17 recommendations to the department and two disclosure issues. Other concerns not having a significant effect on the successful operations of the department are not specifically included in this report but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations made in this report.

We evaluated charges for services in the Internal Service Fund as required by section 17-8-101(6), MCA. We found the charges and fund equity reasonable for the operations in the fund in fiscal years 2006-07 and 2007-08.

Background Information

The Executive Reorganization Act of 1971 established a department to manage the state's natural resources. In 1995, the reorganization of Montana's natural resources and environmental agencies created the current Department of Natural Resources and Conservation. The mission statement of the Montana Department of Natural Resources and Conservation is:

> "To help ensure Montana's land and water resources provide benefits for present and future generations."

The department executes its mission by promoting the stewardship of Montana's water, soil, forest, and rangeland resources, and regulating forest practices and oil and gas exploration and production.

Department Organization

The State Board of Land Commissioners, comprised of the Governor, State Auditor, Attorney General, Superintendent of Public Instruction, and Secretary of State, exercises the general authority, direction, and control over the care, management, and disposition of state lands under its administration. The Department of Natural Resources and Conservation director is the chief administrative officer of the board.

The Reserved Water Rights Compact Commission is attached to the department for administrative purposes. The Reserved Water Rights Compact Commission budgeted for 7.5 full-time equivalent (FTE) positions, was created by the legislature in 1979 as part of the water rights adjudication effort. The commission negotiates water rights with Indian tribes and federal agencies claiming federal reserved water rights within the state in order to establish a formal agreement or compact on the amount of water to be allocated to each interest.

The department's divisions are described below:

Centralized Services Division (41.5 FTE) provides management and administrative support services to the department through the Director's Office and Support Services. The Director's Office includes the director, legal staff, and public information personnel. Support Services includes fiscal affairs, data processing, personnel, reception, and mail. The division manages all financial activities, coordinates information systems and procurement, produces publications and graphic materials, and performs general administrative support services. Other responsibilities include trust revenue collection and distribution, and maintenance of ownership records for trust and nontrust state-owned land.

Oil and Gas Conservation Division (21.5 FTE) administers the Montana oil and gas conservation laws. It promotes conservation and prevents waste in the recovery of oil and gas resources through regulation of exploration and production. The division issues drilling permits; classifies wells; establishes well spacing units and pooling orders; inspects drilling, production, and seismic operations; investigates complaints; and does engineering studies. The division also determines incremental production for enhanced recovery and horizontal wells in order to implement the tax incentive program for those projects, operates the underground injection control program, plugs orphan wells, and collects and maintains complete well data and production information. The division provides administrative support to the Board of Oil and Gas Conservation.

Conservation and Resource Development Division (24.5 FTE) is responsible for administering the Conservation District Act, the Montana Rangeland Resources Act, and the Natural Streambed and Land Preservation Act. In doing so, the division provides technical, administrative, financial and legal assistance to Montana's 58 conservation districts. The division also manages several loan and grant programs for local communities, local governments, state agencies and private citizens. The programs include State Revolving Fund loans to communities for water and waste water systems, Coal Severance Tax loans to governmental entities, and loans to private entities for water development projects. Loans outstanding exceed $130 million at June 30, 2008. Grant programs administered by the division include the Reclamation Development, Renewable Resource, and Conservation District grant programs.

Water Resources Division (157 FTE) is responsible for programs associated with the use, development, and protection of Montana's water. It manages and maintains state-owned dams, reservoirs, and canals. The division develops and recommends intrastate, interstate, and international water policy to the director, governor, and legislature. The division also resolves water resource use conflicts, investigates water use violations, ensures dam safety compliance, and provides water adjudication support to the Water Court. The division consists of an administration unit and four bureaus: Water Management Bureau, Water Rights Bureau, State Water Projects Bureau, and the Water Operations Bureau. The 2003 Legislature attached the Flathead Basin Commission to the department for administrative purposes. The commission is charged with protecting the natural resources and environment of the Flathead Basin.

Forestry Division (161.16 FTE) is responsible for planning and implementing forestry programs statewide. The division protects Montana's natural resources from wildfire, regulates forest practices, and provides a variety of services to private forest landowners. The Fire and Aviation Management Program protects 50 million acres of state and private forest and watershed lands from wildfire through a combination of direct protection and county support. The Forest Practice Regulation program enforces Montana's streamside management zone regulations and monitors the voluntary best management practices program on all forests in Montana. In administering Montana's Fire Hazard Reduction Law, the division helps ensure fire hazards created by logging and other forest management operations on private forestlands are adequately reduced, or that additional fire protection is provided until the hazard is reduced. The division provides technical forestry assistance to private landowners, businesses and communities. It also operates the Tree and Shrub Nursery program, which involves growing and selling seedlings for conservation and reforestation plantings on state and private lands in Montana. In fiscal year 2006-07, the division sold 735,202 seedlings, generating gross revenues of $428,268. In fiscal year 2007-08, 944,050 seedlings were sold for $572,167.

Trust Land Management Division (132.21 FTE) provides for the administration and management of trust lands granted to the state of Montana by the Enabling Act of 1889. In the process of producing revenue for trust beneficiaries, the division considers environmental factors and protects the future income-generating capacity of the trust lands. These lands currently total over 5.1 million surface acres and 6.2 million mineral acres. Additionally, the division is responsible for the administration of approximately 6,000 miles of the beds of navigable waterways. The Trust Land Management Division is divided into four primary programs: forest management, agriculture and grazing management, real estate management and minerals management.

Prior Audit Recommendations

We performed the prior audit of the department for the two fiscal years ended June 30, 2006. The report contained eight recommendations. The department implemented three, partially implemented three, and did not implement two of the recommendations.

The recommendations partially implemented relate to allocations of administrative costs to the various trusts administered by the department. These areas are discussed beginning on page 15. The recommendations not implemented relate to recording unrealized investment gains and losses, and processing surface and ground water rights applications, and are discussed on page 7 and below, respectively.

Surface and Ground Water Rights

Sections 85-2-309 and 85-2-310, MCA, provide for an application process to establish surface and ground water rights. These statutes also specify timeframes required to process the applications.

During each of the past two audits, we noted instances where applications were not processed within the required timeframes. During this audit, we reviewed the current status of water rights applications and determined similar issues exist in fiscal years 2007-08 and 2006-07.

Department personnel stated they have had difficulty meeting the application processing deadlines established in state law due to the volume of objections received and the need to gather additional information from the applicant. In addition, department personnel indicated there were challenges related to turnover during the audit period. Department personnel report the program is currently fully-staffed, but the department is now faced with a significant backlog of hearings currently scheduled through March 2009. Until the backlog is dealt with, the department will be unable to comply with state law. We make no additional recommendation at this time.

Chapter II – Findings and Recommendations

Internal Controls

The department has not fully implemented state accounting policy requirements for establishing, documenting, and maintaining internal controls.

State accounting policy outlines management's responsibility for establishing and maintaining agency internal controls to safeguard and account for the resources entrusted to them to carry out government programs. State policy requires agencies to implement internal control procedures to ensure all transactions necessary for compliance with generally accepted accounting principles are recorded to the state's accounting records prior to fiscal year-end. To assist agencies with the implementation process, the Department of Administration issued an Internal Control Guidebook. The guide includes an internal control evaluation and monitoring plan, which recommends agencies monitor and test internal controls and evaluate and report the results of testing. Auditing standards require us to evaluate and in some cases report on the sufficiency of written control procedures and of the entity's monitoring procedures.

During the audit we noted the Department of Natural Resources and Conservation (department) has implemented control procedures, but for some procedures the department's documentation over internal controls either did not exist or was in insufficient detail. The following examples illustrate areas where the department can enhance its implementation of state accounting policy requirements and suggestions outlined in the guide regarding internal controls.

Fire Revenue and Expenditure Accrual - At the end of each fiscal year, the department estimates fire costs incurred and records amounts that are the responsibility of the federal government in the federal special revenue fund. The federal share of the fire expenditure accrual was $8,458,442 in fiscal year 2006-07 and $27,423,787 in fiscal year 2007-08. During our review of the transaction for fiscal year 2006-07, we noted the department had not documented the process to generate the accrual and did not retain complete support for the transaction. We were able to determine the estimate was reasonable based on a comparison to actual fire costs incurred. In addition, the department overlooked the need to defer the $6,249,981 portion of the revenue that was not expected to be received within 60 days of fiscal year-end 2006-07, as required by state accounting policy.

Recording Unrealized Investment Gains and Losses - Annually, department personnel distribute unrealized investment gains or losses to each of its permanent fund accounts. Due to an error in this distribution in fiscal year 2005-06, our prior audit report contained a recommendation to the department to establish procedures to ensure the distribution is properly recorded on the state's accounting records. For fiscal year 2006-07, the distribution was recorded properly. However, for fiscal year 2007-08, department personnel recorded only a portion of the unrealized investment gains on behalf of its permanent fund accounts. Department personnel indicated that the error occurred in spite of a review of the trial balance prior to the end of the fiscal year. As a result, Permanent Fund revenues and expenditures are understated by $1,461,097 in fiscal year 2007-08.

Overstated Revenue Estimates - During both fiscal years 2006-07 and 2005-06, the department made entries to the state's accounting records to adjust revenue estimates for fiscal year 2006-07. The report the department uses to monitor revenue estimates balances did not include the entry made during fiscal year 2005-06 causing the department to record the second transaction. Because the department was not aware that the original transaction was not reflected in the report, their procedures to monitor revenue estimates were not effective. As a result, Estimated Revenues and Transfers-In are overstated by $15,834,684 on the department's Schedule of Total Revenues & Transfers-In for fiscal year 2006-07.

Schedule of Expenditures of Federal Awards - Annually, the Office of Budget and Program Planning requires each state agency to submit a Schedule of Expenditures of Federal Awards (SEFA). The SEFA submitted by the department for fiscal year 2006-07 did not include expenditures incurred for the federal Fire Management Assistance grant. As a result, the department's SEFA is understated by $8,101,049. Department personnel believed this was a fee for service program rather than a federal grant.

Personnel Services - Department personnel review a validation report prior to processing payroll to ensure information submitted on electronic employee timesheets is recorded properly. In addition, department personnel use a form to document employee hires, salary changes, promotions, and terminations. Information on the form, including wage rate and position number, is input to the state's accounting system, which is then used during payroll processing. In a sample of 31 payroll transactions, we identified one instance where the validation report did not correspond to the employee's timesheet, one instance where an employee was being paid for time worked when the employee's file contained a form for termination, and one instance where the review of the validation report did not prevent an employee from being paid overtime when the employee had not yet worked 40 hours for that week. Department personnel indicated that the validation report is reviewed one time for each pay period, and sometimes all timesheet information is not included on the validation report at the time of review. Department staff also said that inputting the termination information from the form was overlooked.

These errors could have been identified if the department had implemented procedures to monitor internal controls.

Bonus Program - The department has established a policy for employee bonuses that lists specific criteria to qualify for an award and limits individual employees to receiving one award in a 12-month period. Department records indicate 57 and 67 bonuses were awarded in fiscal years 2006-07 and 2007-08, respectively. During our audit, we determined documentation required to support bonuses was missing for 27 awards. In addition, we identified four employees who received two bonuses within a 12-month period. In two cases, employees had changed jobs within the department and the new supervisors were not aware the employees had received a bonus within the last twelve months. The department could have prevented noncompliance with its bonus policy by maintaining a list of bonus payments, including the recipients and the dates of the awards, and reviewing the list prior to awarding bonuses. In addition, the use of a more formal nomination form could ensure all documentation required to support bonuses is obtained.

Summary

Our audit also identified other instances where the department can enhance internal controls and documentation, implementation, monitoring and testing over internal controls. Table 1 on page 1 includes references to recommendations related to significant deficiencies in the department's internal controls. In addition, the recommendations regarding fire charges and donated assets, beginning on pages 14 and 23, respectively, address other internal control deficiencies identified during our audit.

Recommendation #1

We recommend the department enhance, document, implement, monitor, and test internal controls, as required by state accounting policy.

Fire Season Costs

The department is responsible for wildfire suppression on over 50 million acres of state and private property. In recent years, Montana has experienced significant fire activity. Table 2 summarizes recent fire activity in Montana.

Table 2
Summary of Fire Activity for the Past Six Calendar Years

Calendar Year	Number of Fires	Total Acres Burned
2002	1,372	110,309
2003	2,326	736,809
2004	1,447	18,445
2005	1,316	103,294
2006	2,302	1,047,118
2007	1,875	778,079
Average	**1,753**	**403,195**

Source: The Department of Natural Resources and Conservation Website.

We audit fire financial activity accounted for by the department as part of our biennial audits of the department. Our audit report (04-17) that included fire activity from calendar year 2003 included recommendations to the department to clarify policies regarding the review, approval and processing of expenditure claims submitted for fire costs. In the subsequent audit of the department, we concluded the department implemented our audit recommendation. However, as the table above shows, the level of fire activity was significantly smaller.

During the current audit, we identified issues related to fire costs that are similar to those included in our prior audit report (04-17) which indicates the procedures used by the department are not adequate when significant fire activity occurs. The next four recommendations address areas the department should improve control processes over fire costs.

Equipment Transactions

Fire related equipment costs for calendar year 2007 exceed $40 million, which represents approximately 80 percent of total fire costs for the year. The next two recommendations are related to the department's internal controls over equipment transactions.

The department maintains fire manuals to outline procedures required for all fire activities. Specific to equipment rental, the department's fire manual states the department uses rates included in the National Wildfire Coordinating Group Interagency Incident Business Management Handbook (NWCG Handbook).

As outlined in the procurement agreement with the Department of Administration, the department has delegated authority of up to $100,000 for most purchases, and unlimited authority for fire fighting supplies, forest improvement projects, aircraft, and oil and gas projects. The agreement further specify purchases in excess of $100,000 must go through the competitive bid process and must receive formal approval from the Department of Administration.

Procurement Procedures

The department did not follow procurement and payment procedures during the summer 2007 fire season.

In August 2007, a department employee executed a 6-week lease agreement for an All Terrain Vehicle (ATV) for $7,350. The agreement also specified the department could purchase the ATV at the end of the lease term for $6,800, with credit for lease payments of $5,880. This agreement was used as the basis for leasing 13 additional ATVs, 14 Utility Vehicles (UTVs), and 10 trailers. The department did not apply procurement policies and procedures required by the department's purchasing and contracting manual, nor did the department complete the solicitation of bids required by state policy.

In total, the department paid $252,925 in lease costs during the calendar year 2007 fire season for this equipment. At the end of the fire season, the department purchased 14 ATVs, 12 UTVs, and 4 trailers for an additional $38,100. We estimate the department paid $41,620 in excess of the cost of new equipment for assets leased and subsequently purchased at the end of the lease.

Department personnel said they were trying to implement a recommendation from the Legislative Audit Division's Performance Audit report on Wildfire Management (04P-11), which stated the department should examine cost benefits of renting versus purchasing items for wildfire suppression. However, the equipment was purchased by a variety of department programs and department staff represented that the equipment is not available for assignment to fires. Department administration also represented they were unaware of the agreement entered into by field office employees until the bills started coming in. Had proper procurement procedures been followed, department supervisors would have been involved in obtaining the lease because the competitive bid requirement applied to this activity.

RECOMMENDATION #2

We recommend the department ensure procurement policies and procedures are applied to equipment transactions for fire activities.

Unsupported Charges

The department paid unsupported and unallowed claims for fire equipment costs and charged the state's general fund and the federal government for certain fire costs.

Department policy requires specific documentation be submitted for fire equipment costs, including an emergency equipment use invoice, emergency equipment shift tickets, an emergency equipment rental agreement, a resource order for a specific incident, and completed equipment inspection checklists prior to equipment use as well as when the equipment is released from the incident. Each piece of required documentation is used to ensure costs are necessary and charged to the correct fire for the appropriate amount of time.

During the audit, we noted each lease payment for equipment discussed in the previous section lacked a portion of the documentation required by department policy. Based on our audit, we estimate the department paid $79,635 for time the equipment was not assigned to a specific fire. In addition, the daily lease rates paid for each piece of equipment was in excess of the rates specified in the NWCG Handbook. Of total lease amounts that can be traced to a specific fire, the department paid approximately $109,033 in excess of the rates specified in the NWCG Handbook.

Table 3 summarizes unallowed and unsupported fire equipment costs related to the lease agreement specified in the section above.

Table 3
Summary of Unsupported or Unallowed Fire Equipment Costs

	Total Paid (by Fire Incident)	Amount Paid When Not Assigned to a Specific Fire	Amount in Excess of Specified Rates	Total Unsupported or Unallowed Amount
Jocko	$198,275	$53,213	$95,070	$148,283
Chippy	54,000	26,422	13,963	40,385
Other	650	0	0	0
Total	$252,925	$79,635	$109,033	$188,668

Source: Created by the Legislative Audit Division from support at the Department of Natural Resources and Conservation.

Of the total unsupported or unallowed fire equipment claims, $119,205 were paid by the state's general fund, $42,260 were charged to the Federal Emergency Management Agency, and $27,203 were charged to other federal agencies. Because these costs are unsupported or unallowed, we question the $69,463 charged to federal agencies. In addition, we believe the department improperly utilized state funding sources, which include the governor's emergency funds as well as the supplementary appropriation authority, both paid by the state's general fund, for the $119,205 we could not tie to a specific fire need.

Recommendation #3

We recommend the department:

A. Ensure equipment lease rates are limited to rates allowed by department policy.

B. Establish procedures to ensure claims for fire costs include all documentation required by department policy prior to paying the claims.

C. Seek an alternative funding source for the $119,205 inappropriately charged to the state's general fund fire and emergency appropriations.

Meal Reimbursement Rates

The department paid for meals in excess of the amounts allowed by state law.

Section 2-18-501, MCA, in part, specifies employees must be reimbursed for meals while the employee is conducting state business away from the employee's designated headquarters. The statute also specifies reimbursement rates for each breakfast, lunch and dinner. Section 2-18-502, MCA, further defines the employee's travel status and clarifies time periods that an employee qualifies for meal reimbursement.

Generally, meals for department employees are provided by a fire camp or field kitchen, or are served via sack lunch on the fire line. However, employees directly involved in the suppression of an ongoing fire or employees who are readied for anticipated fires are entitled to meals even when meals are not provided through those methods.

During the audit, we noted the department issued internal guidance for meals not provided at a fire camp, field kitchen, or via sack lunch on a fire line, to be applied during a portion of each fire season. The rates specified in the internal guidance were in excess of rates allowed by state law for employees in travel status. Department personnel indicated they relied on representation from Department of Administration's legal counsel, as described on page 29, in adopting the meal reimbursement policies for fire seasons. However, for calendar year 2007 fire season, the department applied the increased rates to employees in travel status even though the representation from Department of Administration's legal counsel did not address that situation.

Recommendation #4

We recommend the department establish procedures to ensure meal costs are reimbursed at rates allowed by state law for employees in travel status.

Various Fire Charges

The department inappropriately paid for time, supplies, and equipment charged to fires.

During the audit we identified the following discrepancies for certain fire costs:

- We compared three meal receipts, including a total of twelve employee meals, to the employees' timesheets and identified costs for six employee meals were charged to cost centers other than those to which the employees were assigned. In addition, none of the employees' timesheets indicate meal breaks were taken, as required by department policy and the NWCG Handbook.
- In three transactions, department employees charged $2,024 to purchase 22 Nomex vests. The purchase was processed without the documentation required by department policy to ensure necessity for fire purposes.
- A department employee rented a movie using a state purchasing card. The rental was charged to a fire cost center, but the documentation to justify necessity for fire cost purposes was not completed as required by department policy.
- A contractor invoice was submitted with records specifying the dates and times fire crew personnel worked on a particular incident. The time records show a meal break for all fire crew personnel, but the meal break period was billed on the contractor invoice. The invoice was paid as submitted, resulting in a $450 overpayment to the contractor. The documentation does not include final approval by a department employee as required for processing.
- A contractor invoice was paid as submitted, but the invoice contained errors. Based on a review of the time records, we determined the contractor was paid for nine hours in excess of time worked. Total overpayment was $230. The error was not identified by department employees during their review of the documentation.

In some cases, the department's internal controls to review and verify fire costs were not adequately performed to identify problems in claims submitted for payment. In other cases, department staff has questioned whether fire costs were appropriate. Even if department staff believed a bill should not be paid, department supervisors instructed staff to do so. Department employees have not been held accountable for unallowable purchases.

Recommendation #5

We recommend the department discontinue paying for unallowable or unsupported expenditures charged to fires.

Trust Lands Administration

The department administers twelve separate land trusts. Of these, nine were established in the federal Enabling and Morrill Acts and Article X of the Constitution of the State of Montana. The legislature began using trust revenues to finance the cost of administering these trusts in 1963. From 1963 to 2003, the legislature established seven separate funding sources to pay for various types of administration costs. These include the Forest Improvement, Resource Development, Recreational Use, Timber Sale, Trust Land Administration and Commercial Leasing Accounts, and the State Land Bank Fund. Currently, land trust administration costs are recovered through charges against revenues.

Under Montana law, the department has a duty of complete loyalty to each individual trust, solely in the interest of that trust's beneficiaries. Section 72-34-110, MCA, indicates the trustee has a duty to keep trust property separate from other property not subject to the trust and to see that trust property is so designated. In Article X, Section 3, the Constitution of the State of Montana guarantees the public school fund against loss or diversion. The same guarantee exists for the university funds in Article X, Section 10 of the Constitution of the State of Montana. In addition, Article X, Section 11 of the Constitution of the State of Montana indicates that all public land trusts are to be disposed of for the purposes for which they have been granted.

The following sections discuss instances where the department's method of allocating administration costs violates the trust agreements, its trust duty, and state law.

Trust Administration Costs

Trust administration costs do not reflect the actual costs of administering each individual trust.

Under Montana law, the department has a duty of complete loyalty to each trust, solely in the interest of that trust's beneficiaries. In a letter dated September 13, 2005, the Attorney General indicated that in the absence of a specific restriction, the department, as trustee, has a right to reimbursement for expenses incurred in administering each trust. Administrative costs are required to be reasonable, incurred in perpetuating the purpose of the trust, and not for other unrelated matters.

Administration costs are charged or allocated to the land trusts based on trust revenues, a practice established through department policy. The following summarizes how certain administration account costs are charged or allocated to the land trusts as allowed by state law:

- The Forest Improvement Account receives fees assessed against successful timber contract bidders.
- The Resource Development Account receives a portion of each trust's income, currently set at 3 percent.
- The Recreational Use Account receives a portion of the recreational use license fees.
- The Timber Sale Account receives a portion of the timber sale revenue, up to the appropriation for the account.
- The Trust Land Administration Account receives deposits of certain trust income; the maximum deposit is 10 percent of certain Capitol Building Trust revenues and 1.125 percent of the book value of each of the remaining trusts.
- The Commercial Leasing Account receives up to 10 percent of commercial lease revenues.
- The State Land Bank Fund receives up to 10 percent of the proceeds from the sale of trust land conducted for the land banking program.

During our prior audit, we reported the department was unable to demonstrate that the costs incurred in the Forest Improvement, Resource Development, Recreational Use, Timber Sale, Trust Land Administration, and Commercial Leasing accounts were reasonable costs incurred in perpetuating the purpose of each trust and not for other unrelated matters. As a result, we recommended the department maintain its expenditure records in sufficient detail to identify the costs incurred for the benefit of each trust, as well as by type of land use. This would enable the department to demonstrate the administrative charges to each trust are reasonable and provide data sufficient to analyze whether trust revenues are maximized, or if alternative land uses would generate more net revenue.

During the current audit, the department implemented the prior audit recommendation to maintain more detailed expenditure records and to evaluate administrative charges by conducting separate analyses each fiscal year for administration costs incurred for the benefit of each trust. The following tables summarize actual administrative costs charged to each trust, as well as the department's analysis of cost incurred for the benefit of each trust.

Table 4
Comparison of Administrative Cost Allocations for Fiscal Year 2007-08

Grant	Amount Charged Based on Current State Law	Analysis Using New Methodology	Difference
Common School	$8,957,502	$8,158,283	$799,219
University of Montana	4,603	19,642	(15,039)
Montana Tech	23,510	477,146	(453,636)
State Normal School	11,462	91,793	(80,331)
State Reform School	14,919	67,580	(52,661)
School for Deaf & Blind	474,187	71,514	402,673
MSU - Morrill	79,524	132,066	(52,542)
MSU - 2nd Grant	512,517	711,651	(199,134)
Veterans Home	35	250	(215)
Capitol Building	953,821	1,301,856	(348,035)
Sir Estate	-	299	(299)
Total	**$ 11,032,080**	**$11,032,080**	**$ -**

Source: Department of Natural Resources and Conservation records.

Table 5
Comparison of Administrative Cost Allocations for Fiscal Year 2006-07

Grant	Amount Charged Based on Current State Law	Analysis Using New Methodology	Difference
Common School	$8,463,251	$8,265,766	$197,485
University of Montana	1,382	6,617	(5,235)
Montana Tech	17,227	31,713	(14,486)
State Normal School	30,261	74,374	(44,113)
State Reform School	84,243	69,790	14,453
School for Deaf & Blind	297,145	360,407	(63,262)
MSU - Morrill	57,833	54,512	3,321
MSU - 2nd Grant	388,649	262,846	125,803
Veterans Home	22	391	(369)
Capitol Building	787,719	997,636	(209,917)
Sir Estate	46	3,726	(3,680)
Total	**$ 10,127,778**	**$ 10,127,778**	**$ -**

Source: Department of Natural Resources and Conservation records.

According to department personnel, they made no changes in the methods the administrative costs are allocated to the trust accounts because by doing so the department would violate current state law. However, the analysis conducted under the new methodology indicates the Common School, State Reform School, MSU-Morrill, and MSU - second grant trust were each overcharged for administrative costs in fiscal year 2006-07. For fiscal year 2007-08, the analysis indicates the Common School and Montana School for the Deaf and Blind trusts were each overcharged for administrative costs. The overcharges total $1,201,892 and $341,602 for fiscal years 2007-08 and 2006-07, respectively. Alternatives available to the department under current law include paying the costs from existing appropriation authority not funded by assessments to the trusts or seeking relief from the legislature.

The department intends to seek a change in law in the 2009 Legislative Session to further address our recommendation. The department should continue to analyze the actual costs to administer each trust and ensure amounts in excess of actual costs to administer each trust are not allocated to other trusts.

Recommendation #6

We recommend the department:

A. Continue to maintain expenditure records in sufficient detail to identify the administration costs incurred for the benefit of each trust.

B. Seek a change in legislation to establish an expenditure allocation method that results in reasonable and appropriate cost allocations to each individual trust.

C. Repay the $1,543,494 inappropriately withheld from Common School, State Reform School, MSU-Morrill, MSU-second grant, and Montana School for the Deaf and Blind trust revenues to the trusts and their beneficiaries.

Maximum Deposits

The Common School Trust paid administrative costs on behalf of other trust funds for the third fiscal year in a row because deposits to the Trust Land Administration Account was limited.

Section 77-1-109, MCA, limits deposits to the Trust Land Administration Account to 10 percent of certain Capitol Building Trust revenues and 1.125 percent of the book value of the remaining trusts. During the prior audit, we reported allocations to the Trust Land Administration Account were inappropriately paid by the Common School Trust and recommended the department seek legislation to establish a mechanism for funding the Trust Land Administration Account when initial allocations exceed the maximum deposit amounts established by law. The department attempted to address this issue during the 2007 Legislative Session, but the bill did not pass.

During fiscal year 2006-07, the Common School Trust paid $6,464 of Trust Land Administration fees on behalf of the Montana School for the Deaf and Blind Trust. The department's procedures to compile and review the transaction did not prevent the error. However, when the department identified the error during fiscal year 2007-08, they immediately recorded correcting entries to the state's accounting records.

Department personnel indicated they charged the excess amount to the Common School trust because the alternative funding mechanism was not approved by the 2007 Legislature, and because the Common School Trust is a large enough trust for there to be minimal impact. However, at the end of fiscal year 2006-07, the cash balance in the department's Trust Land Administration account was $9,686. Therefore, it was not necessary to recover the $6,464 in fees.

Recommendation #7

We recommend the department:

A. Refrain from charging any trust fund an amount in excess of that allowed by law.

B. Seek legislation to establish a mechanism for funding the Trust Land Administration Account when initial allocations exceed the maximum deposit amounts allowed by state law.

Trust Lands Leases

The department has not collected fair market value for rental of state trust lands.

In October 2006, the department used proceeds from previous land sales to purchase the Eustance Ranch property located in Cascade County for the benefit of the Common School trust. The department entered into a lease agreement with a private citizen for approximately half of the property. For the nonleased portion of the land the department entered into an agreement with the Department of Fish, Wildlife and Parks to purchase a permanent easement. Under the agreement, the Department of Fish, Wildlife and Parks pays a specified amount per year for up to five years, at which time the right to purchase the easement expires. Should the easement agreement be fully executed, any payments made during the five year period will be credited to the purchase of the easement. The department has not leased the trust land involved in the easement option, and is therefore not collecting rent income that could be distributed to the Common School trust beneficiary. Until such time as the easement is completed, the department should require fair market rent be paid to the trust. The department estimated the land could support a grazing lease that could earn $576 annually.

The easement agreement further specifies a purchase price equivalent to the price the department paid for the land in October 2006. However, the department acquired this land at a price $251,344 less than the appraised value. The department should amend the easement purchase agreement to reflect fair market value of the property and to fully compensate the trust.

Recommendation #8

We recommend the department maximize trust revenues as required by their fiduciary duty to the trust by:

A. Leasing property acquired under the Eustance Ranch transaction to the fullest extent possible.

B. Ensuring fair market value is reflected in the final easement transaction with the Department of Fish, Wildlife and Parks.

Accounting Issues

Section 17-1-102, MCA, in part, requires each state agency to record the transactions necessary to ensure the state's accounting records present the proper receipt, use, and disposition of all property for which it is accountable in accordance with generally accepted accounting principles by fiscal year-end. The following sections outline how the department can enhance compliance with this statutory requirement.

Land Banking

The department did not consider all accounting entries necessary to properly record land banking activities.

As of April 13, 2003, the department was authorized to administer a land banking program for state trust lands. Under this program, the department sells or exchanges trust lands that are isolated or ineffective to manage and, using those proceeds, acquires replacement trust lands with higher long-term income potential. In fiscal year 2006-07, the first land banking transactions were completed. During the audit, we identified the following accounting error related to land banking transactions.

A private nonprofit organization contributed $200,000 towards the purchase of the Tongue River Ranch property. The department did not properly record transactions to the state's accounting records to reflect the contribution as required by state accounting policy. Department personnel indicated they did not record this contribution on the ledger that supports the department's financial schedules because the department felt trust beneficiaries would believe the revenue should be distributed to them.

For other land banking purchases, department personnel indicated the purchase agreements were provided to staff responsible for recording transactions on the state's accounting records, but additional terms related to the purchases were not always provided to those staff. The lack of information did not lead to additional errors in the accounting records for those transactions. However, the department should ensure all information about land banking purchases is provided to those responsible for recording the transactions on the state's accounting records.

Recommendation #9

We recommend the department implement procedures to ensure all information regarding land banking transactions is communicated to those responsible for recording the activity on the state's accounting records.

Equipment Capitalization

The department undervalued certain equipment on the state's accounting records.

As described in the section beginning on page 10, the department leased and subsequently purchased ATVs, UTVs, and trailers initially utilized for fire activities. Generally accepted accounting principles state, in part, "If at its inception… a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease by the lessee." One of the four criteria is a bargain purchase option, which allows the lessee to purchase the leased property for a price sufficiently lower than the expected fair value of the property at the date the purchase option becomes available. The single lease agreement used as the basis for subsequent equipment leases included a bargain purchase clause. As a result, the value of the equipment on the state's accounting records should include total lease payments, as well as the additional amount necessary to purchase the equipment.

During the audit, we questioned why the department had valued the equipment at only the additional $38,100 paid to purchase the equipment, rather than including the entire amount of the lease payments as required by generally accepted accounting principles. Department personnel stated they did not think the capital lease criteria applied to the transactions. After we discussed the capital lease requirements with the department, the department recorded transactions to the state's accounting records to increase the value of the equipment by $179,880.

Because the department was credited 80 percent of total lease payments towards the purchase of the equipment, the department only increased the value of the equipment by that portion of the total lease payments. However, the department should have increased the value of the equipment for all lease payments. As a result, Other Services are overstated and Equipment is understated by approximately $50,500 on the department's Schedule of Total Expenditures & Transfers-Out for Forestry/Trust Lands Division for fiscal year 2007-08.

Recommendation #10

We recommend the department capitalize the remaining $50,500 in lease payments as required by state law.

Donated Assets

The department did not appropriately value certain assets on the state's accounting records.

When the federal Department of Defense is done using certain equipment, the equipment is donated to various state and local governments. The federal government asks receiving entities to track equipment at the original acquisition cost. However, at the time the equipment is provided to other government entities, the fair value of the equipment is considerably less than the acquisition amount. State accounting policy requires gifts and donations be recorded at their fair market value on the date of receipt.

During fiscal years 2007-08 and 2006-07, the department received equipment from the federal Department of Defense along with the title to the equipment. The paperwork submitted to the department's purchasing bureau listed only the original acquisition value of the equipment, not the fair market value. Department personnel responsible for recording the assets to the state's accounting records were not aware the equipment was donated and no longer worth the original acquisition amount. As a result, the department overvalued the equipment on the state's accounting records.

Recommendation #11

We recommend the department establish procedures to ensure property donated from the federal Department of Defense is recorded in accordance with state law and policy.

Nontrust Revenues

The department distributed certain funds instead of investing them in the corpus of the Common School trust.

Each year the department receives revenue from the federal Bureau of Land Management for payment of 5 percent of net proceeds from the sale of public lands and materials within the state. Since at least fiscal year 2002-03, the department has recorded this revenue to the Taylor Grazing account code on the state's accounting records. The Enabling Act of 1889 specifies proceeds from the sale of public lands within the state be used as a permanent fund, the interest of which only shall be expended for the support of common schools.

During fiscal year 2006-07, the department incorrectly concluded that the amount recorded to the Taylor Grazing account was related to Taylor Grazing revenue. The department's conclusion caused an inappropriate distribution of $48,823 to the Common School trust beneficiary in fiscal year 2006-07. The revenue received in fiscal year 2007-08 was also initially distributed to the Common School trust beneficiary. However, when the department became aware of the inappropriate classification, it processed correcting entries to the state's accounting records.

Recommendation #12

We recommend the department deposit revenue from the sale of public land to the permanent fund, as required by the Enabling Act.

Property Held in Trust

The department does not consistently and appropriately account for property held in trust.

State accounting policy specifies fiduciary funds should be used to report assets held in a trustee capacity. Fiduciary funds cannot be used to support the government's own programs and activities. During the audit, we reviewed three of the department's fiduciary activities and noted discrepancies in how the department accounts for those activities, including the proper fund classification.

- The department accepts cash, certificates of deposit, letters of credit, and surety bonds from permit holders as security for the timber program, but only records the cash as property held in trust in the department's agency fund. Certificates of deposit meet the definition of an asset, and should also be recorded on the state's accounting records. At the time of our audit, the department held three certificates of deposit totaling $202,467. Department staff responsible for receiving timber program securities did not think certificates of deposit needed to be recorded on the state's accounting records. Additionally, the activity recorded for the timber program meets the criteria of a private-purpose trust fund. The department was not aware of the criteria, therefore, they did not reclassify the agency fund activity when accounting policy changed effective July 1, 2001.

- For agricultural and grazing activities, the department accepts competitive bids towards the end of the existing lease period. Bid packets must include a payment for one year of the lease. None of the bid deposits are returned for up to several weeks while the existing lease holder is provided an opportunity to exercise the right of renewal by matching the high bid. Because the bid payments cannot be used to support the state's programs, the funds should be deposited to the department's agency fund and recorded as property held in trust on the state's accounting records. After the lease is awarded, the department should refund the amounts from unsuccessful bidders.
- For sales of trust lands, the department requires a bid deposit be submitted in advance of the land auction. As bid deposits are received, they are recorded as property held in trust in the state special revenue fund. After the land auction, the successful bid is applied to the land sale, while unsuccessful bids are promptly returned by issuing a warrant from the state treasury. Because the bid payments cannot be used to support the state's programs, they should be recorded as property held in trust in the department's agency fund rather than in the state special revenue fund.

Department personnel pointed to employee workload issues, and the fact that a significant amount of agricultural and grazing bids are returned as the reasons bids are not deposited to the treasury and recorded, on the state's accounting system. Department personnel also indicated the different treatment of bids may be related to higher bid amounts for land banking than for agricultural and grazing leases.

Section 17-6-105, MCA, in part, requires all money received by a state agency be deposited with the state treasurer at least once per week or any time total collections exceed $750. This statute does provide for modified deposit schedules, if requested by the state agency and approved by the Department of Administration.

Recommendation #13

We recommend the department:

A. Record its fiduciary activities appropriately on the state's accounting records as required by state law and policy.

B. Deposit all bid receipts as required by state law.

Revenue Recognition

The department did not record a $41 million settlement agreement on the state's accounting records.

In June 2008, courts ordered a company to pay $41 million to the state for a portion of the revenue generated from dams located on state trust lands. This revenue represented back rent due from 2000 to 2007. During the fiscal year-end process, the department did not record transactions on the state's accounting records for this activity as required by state law and policy. Department personnel indicated they anticipate the court decision will be appealed as the reason the transactions were not recorded. However, the department does not have controls in place to consider the potential financial ramifications from ongoing litigation as part of the department's fiscal year-end procedures. As a result, assets and liabilities are each understated by $41 million on the state's accounting records in the ledger that supports the state's Basic Financial Statements.

Recommendation #14

We recommend the department:

A. Implement procedures to ensure the results of litigation are considered during the fiscal year-end process in accordance with state law and policy.

B. Record transactions to properly reflect the $41 million settlement in accordance with state law and policy.

Investment Earnings

The department invested administrative cost allocations without statutory authority.

During the audit, we noted the department invested funds available for administrative costs of the land banking program in the state's Short Term Investment Pool. Section 17-6-202, MCA, in part, states that absent specific statutory authorization to invest funds, all money is invested in the state's treasury cash account, the interest of which is credited to the state's general fund. No specific authorization exists in state law for the department's investment of unused administrative cost allocations. As a result, interest earnings legally belonging to the general fund of $2,025 and $21,173 in fiscal years 2007-08 and 2006-07, respectively, were inappropriately retained by the department.

Recommendation #15

We recommend the department:

A. Invest funds only when authorized to do so under state law.

B. Repay the general fund the $23,198 for earnings the department was not authorized to retain.

Indirect Cost Recoveries

The department did not recover indirect costs as required by state law.

The department administers the federal Fire Management Assistance grant. As part of this assistance, the department is entitled to receive funding for costs incurred in administering the grant. The department's approved indirect cost recovery rates were 5.42 percent and 6.41 percent of the grant for fiscal years 2007-08 and 2006-07, respectively. However, the department did not recover indirect costs for either fiscal year. Department personnel indicated they do not bill indirect costs for the Fire Management Assistance grant due to a gentlemen's agreement.

Section 17-1-106, MCA, in part, states an agency may not waive or otherwise forfeit the agencies ability to recover indirect costs that are otherwise allowable costs under the program. By not charging indirect costs, the department did not recover indirect costs of $1,145,450 and $415,399 in fiscal years 2007-08 and 2006-07, respectively. Because the department's administrative costs are paid by the general fund, any indirect cost recoveries should be recorded in the state's general fund.

Recommendation #16

We recommend the department recover indirect costs to the fullest extent possible, as required by state law.

Suspended or Debarred Parties

The department cannot demonstrate that contracts for fire services are awarded to parties not suspended or debarred from receiving federal dollars.

In years where a federal emergency has been declared for fire activities, the department administers the Fire Management Assistance grant from the federal Department of Homeland Security. Federal regulations require the department to ensure and document that federal dollars are not provided to any party which is suspended or debarred participating in federal programs. Prior to each fire season, the department contracts with vendors to provide services for the upcoming fire season. During the solicitation process, the department represents they verified the vendors are not suspended or debarred from receiving federal funds. However, the department does not retain documentation of the verification. Without documentation that a vendor's suspension and debarment status was considered, the department cannot demonstrate compliance with the federal requirement.

Recommendation #17

We recommend the department document compliance with federal requirements that prohibit contracting with suspended and debarred parties.

Chapter III – Disclosure Issues

Meal Reimbursement

As described beginning on page 13, state law specifies meal reimbursement rates for employees in travel status conducting state business. State law is silent in regards to meals provided to employees who are not in travel status. During the audit, we noted the department paid for meals for employees who were not in travel status.

In April 2006, the department sought legal advice from the Department of Administration regarding meals for employees not in travel status, but who were being asked to remain at their work station past their regular shift. The department indicated meal reimbursement for employees who are asked to work extended hours during fire season supports employee morale. The Department of Administration's legal counsel indicated the state's travel policies did not address employees who were not in travel status, and that the department could provide meals to those employees. In a meeting held prior to the start of calendar year 2008 fire season, the department was reminded by Department of Administration's Accounting Bureau personnel that state law does not address meal reimbursement rates for state employees not in travel status, and was advised to seek legislation to address the specific needs for employee meals that occur during fire season.

This information is presented for disclosure purposes only, and we make no recommendation at this time.

Hydroelectric Dam Settlements

In October 2003, two Gallatin County residents who were later joined by the state and Great Falls school districts, sued utility companies for compensation related to the utility companies' use of navigable waterways for their dams, arguing the state riverbeds are part of the school trust lands. A court decision resulted in the state of Montana remaining as the sole plaintiff in the lawsuit.

In June 2008, PPL Montana was ordered to pay $41 million in back rent for hydroelectric dams located on state-owned riverbeds. Prior to this court decision, two other companies agreed to pay the state over $4 million per year in rent for other dams. While the PPL Montana decision recognizes rent from year 2000 to 2007, the time period the company owned and operated the dams, the other settlements only address rents going forward from 2007. Most of these revenues relate to state lands administered by the department on behalf of the Common School trust and revenue received is distributable for the support of Common Schools.

Article X, Section 3, of the Constitution of the State of Montana guarantees the public school fund against loss or diversion. It is possible the agreements reached with Avista Corp. and PacifiCorp violate the Constitution of the State of Montana because they do not address back rents for land use prior to 2007. This information is presented for disclosure purposes only, and we make no recommendation at this time.

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2008, and 2007. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities and cash flows.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2008, and 2007, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 23, 2008

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DEPARTMENT OF NATURAL RESOURCE & CONSERVATION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Permanent Fund
FUND BALANCE: July 1, 2007	$ (9,227,829)	$ 296,883,398	$ 188,754	$ 34,975,113	$ 14,884	$ 119,676	$ 0	$ 439,889,052
PROPERTY HELD IN TRUST: July 1, 2007							$ 1,869,781	
ADDITIONS								
Budgeted Revenues & Transfers-In	255,475	189,119,904	12,888,166		579,990	2,217,980		
Nonbudgeted Revenues & Transfers-In	66,578	75,268,156	9	16,695,958	24	552		133,684,582
Prior Year Revenues & Transfers-In Adjustments	(55)	(84,889)	(7,379,219)	1,350,362				(794)
Direct Entries to Fund Balance	71,730,149	(57,412,914)	60,936,609	418,373	(1)	1		18,633
Additions to Property Held in Trust							4,979,574	
Total Additions	72,052,147	206,890,256	11,602,565	18,464,693	580,013	2,218,533	4,979,574	133,702,420
REDUCTIONS								
Budgeted Expenditures & Transfers-Out	71,796,821	29,578,015	38,612,477		559,891	2,058,088		
Nonbudgeted Expenditures & Transfers-Out	216	87,410,982		22,363,338	8,702	58,252		123,458,395
Prior Year Expenditures & Transfers-Out Adjustments	1,346,818	(102,167)	(1,625,693)	1,189,827		19,874		(33,851)
Reductions in Property Held in Trust							4,836,136	
Total Reductions	73,143,855	116,886,830	36,986,784	23,553,165	568,593	2,136,214	4,836,136	123,424,544
FUND BALANCE: June 30, 2008	$ (10,319,537)	$ 386,886,824	$ (25,195,465)	$ 29,886,641	$ 26,304	$ 201,995	$ 0	$ 450,166,929
PROPERTY HELD IN TRUST: June 30, 2008							$ 2,013,219	

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Permanent Fund
FUND BALANCE: July 1, 2006	$ (2,911,355)	$ 246,051,212	$ 42,739	$ 36,863,778	$ (12,981)	$ 175,091	$ 0	$ 428,073,554
PROPERTY HELD IN TRUST: July 1, 2006							$ 2,382,938	
ADDITIONS								
Budgeted Revenues & Transfers-In	454,691	99,380,726	18,158,604		467,088	1,777,646		
Nonbudgeted Revenues & Transfers-In	59,254	62,242,600	0	15,514,243	37	9,791		133,745,917
Prior Year Revenues & Transfers-In Adjustments	1,520	68,359	3,866	188,746	8			(23,061,351)
Direct Entries to Fund Balance	48,163,921	(37,619,799)	1,177,248	374,922				219,075
Additions to Property Held in Trust							2,105,953	
Total Additions	48,679,386	124,071,886	19,339,718	16,077,911	467,133	1,787,437	2,105,953	110,903,641
REDUCTIONS								
Budgeted Expenditures & Transfers-Out	54,351,068	33,134,041	19,193,807		439,438	1,836,096		
Nonbudgeted Expenditures & Transfers-Out	672,704	40,660,391		17,966,576	(170)	7,410		121,773,288
Prior Year Expenditures & Transfers-Out Adjustments	(27,912)	(554,732)	(104)			(654)		(22,685,145)
Reductions in Property Held in Trust							2,619,110	
Total Reductions	54,995,860	73,239,700	19,193,703	17,966,576	439,268	1,842,852	2,619,110	99,088,143
FUND BALANCE: June 30, 2007	$ (9,227,829)	$ 296,883,398	$ 188,754	$ 34,975,113	$ 14,884	$ 119,676	$ 0	$ 439,889,052
PROPERTY HELD IN TRUST: June 30, 2007							$ 1,869,781	

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS								
Licenses and Permits	$ 480	$ 269,783					$ 438,874	$ 709,137
Taxes	16,096	3,161,058			$ 24	$ 552		3,177,730
Charges for Services	255,423	4,703,367		$ 997,794		1,232,719		7,189,303
Investment Earnings	(233)	4,767,994		8,489,349			28,057,782	41,314,892
Fines, Forfeits and Settlements	26,072	14,000						40,072
Sale of Documents, Merchandise and Property	229	721,941		2,498,325	572,169		12,132,074	15,924,738
Rentals, Leases and Royalties	19,881	257,164					64,250,858	64,527,903
Miscellaneous	3,250	153			7,821			11,224
Grants, Contracts, Donations and Abandonments	800	1,753,624				8,480		1,762,904
Other Financing Sources		248,654,086		6,060,852		976,781	28,804,200	284,495,919
Federal			$ 5,303,998					5,303,998
Federal Indirect Cost Recoveries			204,958					204,958
Total Revenues & Transfers-In	321,998	264,303,170	5,508,956	18,046,320	580,014	2,218,532	133,683,788	424,662,778
Less: Nonbudgeted Revenues & Transfers-In	66,578	75,268,156	9	16,695,958	24	552	133,684,582	225,715,859
Prior Year Revenues & Transfers-In Adjustments	(55)	(84,889)	(7,379,219)	1,350,362			(794)	(6,114,595)
Actual Budgeted Revenues & Transfers-In	255,475	189,119,903	12,888,166	0	579,990	2,217,980	0	205,061,514
Estimated Revenues & Transfers-In	256,800	189,146,198	12,896,404		579,800	2,218,146		205,097,348
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (1,325)	$ (26,295)	$ (8,238)	$ 0	$ 190	$ (166)	$ 0	$ (35,834)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS								
Licenses and Permits		$ 345						$ 345
Taxes		614						614
Charges for Services	$ (759)	(2,392)				$ (31)		(3,182)
Investment Earnings	(178)	(14,219)	$ (9)					(14,406)
Fines, Forfeits and Settlements	(13)							(13)
Sale of Documents, Merchandise and Property	(375)	(5,393)			$ 169			(5,599)
Rentals, Leases and Royalties		233						233
Miscellaneous					21			21
Grants, Contracts, Donations and Abandonments		(773)				(20)		(793)
Other Financing Sources		(4,710)				(115)		(4,825)
Federal			(8,290)					(8,290)
Federal Indirect Cost Recoveries			61					61
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (1,325)	$ (26,295)	$ (8,238)	$ 0	$ 190	$ (166)	$ 0	$ (35,834)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS								
Licenses and Permits	$ 1,321	$ 272,155					$ 1,017,961	$ 1,291,437
Taxes	14,133	2,591,358			$ 37	$ 553		2,606,081
Charges for Services	444,769	4,447,433		$ 8,807	32,250	975,818		5,909,077
Investment Earnings	1,015	4,948,019		7,338,022			29,245,379	41,532,435
Fines, Forfeits and Settlements	17,457	65,195						82,652
Sale of Documents, Merchandise and Property	8,538	536,319		3,057,190	428,274		14,086,444	18,116,765
Rentals, Leases and Royalties	19,875	284,159					50,456,167	50,760,201
Miscellaneous	2,907	11,203			6,572			20,682
Grants, Contracts, Donations and Abandonments		1,362,131						1,362,131
Other Financing Sources	5,450	147,173,004		5,298,970		811,066	15,878,615	169,167,105
Federal		709	$ 17,915,667					17,916,376
Federal Indirect Cost Recoveries			246,803					246,803
Total Revenues & Transfers-In	515,465	161,691,685	18,162,470	15,702,989	467,133	1,787,437	110,684,566	309,011,745
Less: Nonbudgeted Revenues & Transfers-In	59,254	62,242,600		15,514,243	37	9,791	133,745,917	211,571,842
Prior Year Revenues & Transfers-In Adjustments	1,520	68,359	3,866	188,746	8		(23,061,351)	(22,798,852)
Actual Budgeted Revenues & Transfers-In	454,691	99,380,726	18,158,604	0	467,088	1,777,646	0	120,238,755
Estimated Revenues & Transfers-In	455,102	83,485,011	18,176,311		467,000	1,779,250		104,362,674
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (411)	$ 15,895,715	$ (17,707)	$ 0	$ 88	$ (1,604)	$ 0	$ 15,876,081
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS								
Licenses and Permits	$ (12)	$ (43)						$ (55)
Taxes		(5,653)	$ (25)			$ (250)		(5,928)
Charges for Services	(470)	(2,096)			$ (251)	(420)		(3,237)
Investment Earnings	15	76,590	(1,090)					75,515
Fines, Forfeits and Settlements	(41)	195						154
Sale of Documents, Merchandise and Property	(13)	720			267			974
Rentals, Leases and Royalties		(25)						(25)
Miscellaneous	110	(1)			72			181
Grants, Contracts, Donations and Abandonments		(164)						(164)
Other Financing Sources		15,826,192				(934)		15,825,258
Federal			(15,988)					(15,989)
Federal Indirect Cost Recoveries			(604)					(604)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (411)	$ 15,895,715	$ (17,707)	$ 0	$ 88	$ (1,604)	$ 0	$ 15,876,080

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	CENTRALIZED SERVICES	CONSERVATION & RESOURCE DEVELOPMENT DIVISION	FORESTRY & TRUST LANDS	OIL & GAS CONSERVATION DIVISION	RESERVED WATER RIGHTS COMPACT COMMISSION	TRUST FUNDS	WATER RESOURCES DIVISION	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT								
Personal Services								
Salaries	$ 1,875,529	$ 1,142,539	$ 13,161,967	$ 810,872	$ 457,429		$ 6,699,457	$ 24,147,793
Hourly Wages			5,822,145		641		550	5,823,336
Other Compensation		802		8,850	3,357		200	13,209
Employee Benefits	551,120	358,003	5,007,010	252,238	128,753		2,166,262	8,463,386
Personal Services-Other			21,278					21,278
Total	2,426,649	1,501,344	24,012,400	1,071,960	590,180		8,866,469	38,469,002
Operating Expenses								
Other Services	429,129	1,941,253	67,999,610	923,722	922,834		3,165,114	75,381,662
Supplies & Materials	109,951	47,156	4,341,791	81,018	9,229		479,702	5,068,847
Communications	81,573	43,911	602,682	41,865	8,931		192,374	971,336
Travel	27,911	79,493	988,356	45,677	32,883		157,855	1,332,175
Rent	184,659	73,639	7,103,797	21,723	43,387		726,922	8,154,127
Utilities	23,206	6,194	369,467	14,579	5,527		8,771	427,744
Repair & Maintenance	5,778	6,196	1,302,053	22,642			34,501	1,371,170
Other Expenses	25,634	69,465	1,118,189	52,818	2,862		254,167	1,523,135
Goods Purchased For Resale			10,800					10,800
Total	887,841	2,267,307	83,836,745	1,204,044	1,025,653		5,019,406	94,240,996
Equipment & Intangible Assets								
Equipment	7,155	45,141	1,337,123	47,672			128,986	1,566,077
Intangible Assets							8,795	8,795
Total	7,155	45,141	1,337,123	47,672			137,781	1,574,872
Capital Outlay								
Land & Interest In Land			66,788				3,000	69,788
Total			66,788				3,000	69,788
Grants								
From State Sources		3,429,208	210,294	3,000				3,642,502
From Federal Sources			3,077,015					3,077,015
From Other Sources			168,012					168,012
Total		3,429,208	3,455,321	3,000				6,887,529
Benefits & Claims								
OPEB Expenses			59,201					59,201
Total			59,201					59,201
Transfers								
Accounting Entity Transfers	16,885	85,592,060	1,475,609			$ 134,893,635	43,978	222,022,167
Intra-Entity Expense			105,616			3,913,900		4,019,516
Total	16,885	85,592,060	1,581,225			138,807,535	43,978	226,041,683
Debt Service								
Bonds		8,941,427						8,941,427
Loans		22,353					384,812	407,165
Capital Leases			8,322					8,322
Total		8,963,780	8,322				384,812	9,356,914
Total Expenditures & Transfers-Out	$ 3,338,530	$ 101,798,840	$ 114,357,125	$ 2,326,676	$ 1,615,833	$ 138,807,535	$ 14,455,446	$ 376,699,985
EXPENDITURES & TRANSFERS-OUT BY FUND								
General Fund	$ 2,527,536	$ 1,745,451	$ 60,486,064		$ 772,958		$ 7,611,846	$ 73,143,855
State Special Revenue Fund	681,198	76,201,784	16,174,085	$ 2,000,427	842,875	$ 15,382,991	5,603,470	116,886,829
Federal Special Revenue Fund	129,796	304,293	34,992,169	326,249			1,234,277	36,986,785
Debt Service Fund		23,547,312					5,853	23,553,165
Enterprise Fund			568,593					568,593
Internal Service Fund			2,136,214					2,136,214
Permanent Fund						123,424,544		123,424,544
Total Expenditures & Transfers-Out	3,338,530	101,798,840	114,357,125	2,326,676	1,615,833	138,807,535	14,455,446	376,699,985
Less: Nonbudgeted Expenditures & Transfers-Out		93,345,555	773,376			138,841,386	339,567	233,299,884
Prior Year Expenditures & Transfers-Out Adjustments	7,758	1,108,656	(256,276)	1,356	(200)	(33,851)	(32,635)	794,808
Actual Budgeted Expenditures & Transfers-Out	3,330,772	7,344,629	113,840,025	2,325,320	1,616,033	0	14,148,514	142,605,293
Budget Authority	3,540,370	28,158,270	122,795,951	3,434,412	16,467,281		19,958,773	194,355,057
Unspent Budget Authority	$ 209,598	$ 20,813,641	$ 8,955,926	$ 1,109,092	$ 14,851,248	$ 0	$ 5,810,259	$ 51,749,764
UNSPENT BUDGET AUTHORITY BY FUND								
General Fund	$ 37,858	$ 10,323	$ 1,065,149		$ 44,123		$ 240,829	$ 1,398,282
State Special Revenue Fund	141,073	20,803,318	2,145,961	$ 1,017,102	14,807,125		3,342,592	42,257,171
Federal Special Revenue Fund	30,667		5,668,101	91,990			2,226,838	8,017,596
Enterprise Fund			40,109					40,109
Internal Service Fund			36,606			$		36,606
Unspent Budget Authority	$ 209,598	$ 20,813,641	$ 8,955,926	$ 1,109,092	$ 14,851,248	$ 0	$ 5,810,259	$ 51,749,764

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES & CONSERVATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	Centralized Services	Conservation Resource Development Division	Forestry Trust Lands	Oil & Gas Conservation Division	Reserved Water Rights Compact Commission	Trust Funds	Water Resources Division	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT								
Personal Services								
Salaries	$ 1,601,552	$ 1,138,641	$ 12,397,797	$ 787,815	$ 463,883		$ 6,258,943	$ 22,648,631
Hourly Wages	573		4,441,097					4,441,670
Other Compensation		600	11	7,603	6,766		300	15,280
Employee Benefits	428,286	345,547	4,407,639	241,035	123,294		1,977,763	7,523,564
Personal Services-Other			4,140					4,140
Total	2,030,411	1,484,788	21,250,684	1,036,453	593,943		8,237,006	34,633,285
Operating Expenses								
Other Services	235,380	2,359,471	34,891,993	910,430	133,820		3,679,241	42,210,335
Supplies & Materials	74,683	73,518	3,129,994	73,691	14,455		266,289	3,632,630
Communications	70,040	39,097	403,027	48,391	11,581		173,938	746,074
Travel	25,901	80,557	742,937	44,291	36,495		131,913	1,062,094
Rent	180,487	71,547	7,387,079	22,707	40,749		614,044	8,316,613
Utilities	21,366	5,669	220,746	15,341	4,796		8,085	276,003
Repair & Maintenance	2,235	4,908	1,074,184	22,715	600		23,736	1,128,378
Other Expenses	24,391	42,995	437,530	51,697	1,034		218,428	776,075
Goods Purchased For Resale			8,364					8,364
Total	634,483	2,677,762	48,295,854	1,189,263	243,530		5,115,674	58,156,566
Equipment & Intangible Assets								
Equipment	(732)	(6,504)	989,631	74,146			16,680	1,073,221
Total	(732)	(6,504)	989,631	74,146			16,680	1,073,221
Capital Outlay								
Land & Interest In Land			57,015			$ 9,096,766	3,000	9,156,781
Total			57,015			9,096,766	3,000	9,156,781
Grants								
From State Sources		9,243,698		3,000				9,246,698
From Federal Sources			3,336,234					3,336,234
Total		9,243,698	3,336,234	3,000				12,582,932
Transfers								
Accounting Entity Transfers		46,096,018	2,648,311			86,299,207	1,000,000	136,043,536
Intra-Entity Expense			59,315			3,692,170		3,751,485
Total		46,096,018	2,707,626			89,991,377	1,000,000	139,795,021
Debt Service								
Bonds		10,967,984						10,967,984
Loans							391,990	391,990
Capital Leases			8,322					8,322
Total		10,967,984	8,322				391,990	11,368,296
Total Expenditures & Transfers-Out	$ 2,664,162	$ 70,463,746	$ 76,645,366	$ 2,302,862	$ 837,473	$ 99,088,143	$ 14,764,350	$ 266,766,102
EXPENDITURES & TRANSFERS-OUT BY FUND								
General Fund	$ 2,080,082	$ 1,843,536	$ 42,693,340		$ 837,473		$ 7,541,429	$ 54,995,860
State Special Revenue Fund	391,145	50,363,907	14,816,998	$ 1,779,089			5,888,561	73,239,700
Federal Special Revenue Fund	192,935	295,580	16,852,908	523,773			1,328,507	19,193,703
Debt Service Fund		17,960,723					5,853	17,966,576
Enterprise Fund			439,268					439,268
Internal Service Fund			1,842,852					1,842,852
Permanent Fund						$ 99,088,143		99,088,143
Total Expenditures & Transfers-Out	2,664,162	70,463,746	76,645,366	2,302,862	837,473	99,088,143	14,764,350	266,766,102
Less: Nonbudgeted Expenditures & Transfers-Out	1,109	57,063,264	1,922,311	(356)	(248)	121,773,288	320,830	181,080,198
Prior Year Expenditures & Transfers-Out Adjustments	5,720	(556,605)	(21,768)	(4,687)	(33)	(22,685,145)	(6,029)	(23,268,547)
Actual Budgeted Expenditures & Transfers-Out	2,657,333	13,957,087	74,744,823	2,307,905	837,754	0	14,449,549	108,954,455
Budget Authority	2,682,837	19,247,343	85,707,610	3,767,142	857,337		15,840,237	128,102,506
Unspent Budget Authority	$ 25,504	$ 5,290,256	$ 10,962,787	$ 1,459,237	$ 19,583	$ 0	$ 1,390,688	$ 19,148,055
UNSPENT BUDGET AUTHORITY BY FUND								
General Fund	$ 14,151	$ 21,986	$ 3,637,417		$ 19,583		$ 111,658	$ 3,804,795
State Special Revenue Fund	3,700	5,243,111	838,002	$ 1,145,874			794,372	8,025,059
Federal Special Revenue Fund	7,653	25,159	6,329,952	313,363			484,658	7,160,785
Enterprise Fund			48,234					48,234
Internal Service Fund			109,182			$		109,182
Unspent Budget Authority	$ 25,504	$ 5,290,256	$ 10,962,787	$ 1,459,237	$ 19,583	$ 0	$ 1,390,688	$ 19,148,055

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

Montana Department of
Natural Resources and Conservation
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2008

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Debt Service, and Permanent). In applying the modified accrual basis, the department records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary and Fiduciary fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- **General Fund** – to account for all financial resources except those required to be accounted for in another fund.

- **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include Forestry operations, Wastewater and Drinking Water Projects, and the Renewable Resource grants and Loans Program.
- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. The department's fire operations and suppression efforts are financed in part by federal funds.
- **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund for bonds issued to provide funding for renewable resources, coal severance tax, and water development projects.
- **Permanent Fund** – to account for financial resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The department uses this fund for the Common School Trust, university and college trusts, Morrill Trust, School for the Deaf and Blind Trust, State Reform School Trust, Capitol Building Trust, and the Trust and Legacy Account.

Proprietary Fund Category

- **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department's Internal Service Fund contains the Forestry Division's Air Operations Bureau. The Air Operations Bureau maintains and operates aircraft to aid in fire suppression.
- **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. The 2005 Legislature directed the department establish an Enterprise Fund for the State Nursery Program in fiscal year 2005-06. In fiscal year 2004-05, these operations were recorded in the State Special Revenue Fund.

Fiduciary Fund Category

- **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The department's agency funds account for activity such as contractual bonds and hazard reduction.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund balances for each of the fiscal years ended June 30, 2007 and 2008.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General, Special Revenue, Federal Special Revenue Fund, Debt Service, and Permanent funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Direct entries to fund balances in the Debt Service fund also includes a correction of an error from a previous period that occurred at least two fiscal years prior and entries to record or adjust fund balance reservations or designations.

4. Long-Term Debt

During prior fiscal years, the state of Montana issued General Obligation bonds for the Drinking Water State Revolving Fund and Water Pollution Control State Revolving Fund programs. These bonds were used for Drinking Water and Water Pollution Control project loans. At June 30, 2008, the department had a total of $22,065,000 in General Obligation bonds outstanding for these programs.

During prior fiscal years, the state of Montana issued General Obligation bonds for the Renewable Resource Loan program. These bonds were used for private loans for irrigation projects. At June 30, 2008, the department had a total of $2,450,000 of General Obligation bonds outstanding for this program.

During prior fiscal years, the department issued Coal Severance Tax bonds for the Renewable Resource Loan program. These bonds were used for public loans for irrigation, water, sewer and dam projects. At June 30, 2008, the department had a total of $26,790,000 of Coal Severance Tax bonds outstanding.

The department has a loan from the U.S. Bureau of Reclamation to fund the Middle Creek Dam project. The unpaid loan principal and interest during construction balance as of June 30, 2008, was $2,691,512.

The Northern Cheyenne Tribe and the department entered into an agreement on July 1, 1994, in which the tribe agreed to loan the state up to $11,500,000 of federal funds appropriated as part of the Northern Cheyenne Indian Reserved Water Rights Settlement. The non-interest bearing loan was used to help finance the costs of the Tongue River Dam Project. The actual amount of the loan was $11,300,000. The outstanding loan balance at June 30, 2008, was $8,692,308. In March 2005, the department issued Coal Severance Tax bond to the tribe for $9,851,282 as security for the loan. The bond, which is non-interest bearing, provides a means of prepayment to the tribe in the event pledged revenues are insufficient for loan repayment.

5. Other Financing Sources

The Schedule of Total Revenues and Transfers-In contain the following activity in the other financing sources class:

- **General Fund** – This activity represents the proceeds from the sale of fixed assets.
- **State Special Revenue Fund** – A portion of this activity is the transfer of Common School Permanent Trust Fund earnings to the Guarantee Account for distribution to school districts. Transfers-In activity also includes the movement of loans receivable from other funds and the transfer of federal funds from the Department of Environmental Quality for the Clean Water and Drinking Water State Revolving Funds.
- **Debt Service Fund** – This activity is comprised of the movement of loans receivable from other funds.
- **Permanent Fund** – This activity represents the allocation of interest and income within the trust funds administered by the department.

6. Revenue Estimates

During each fiscal year 2005-06 and again in fiscal year 2006-07, the department recorded revenue estimates to State Special Revenue Fund on the state's accounting records. As a result, Estimated Revenues and Transfers-In are overstated by $15,834,684 and Investment Earnings and Other Financing Sources under the Budgeted Revenues & Transfers-In Over (Under) Estimated By Class are overstated by $5,000 and $15,829,684, respectively, on the Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2007, in the State Special Revenue Fund.

7. Negative Prior Year Revenues and Transfers-In Adjustments

Annually, the department distributes unrealized investment gains or losses to the Permanent Funds. In fiscal year 2005-06, the department incorrectly distributed unrealized investment losses to the Permanent Funds as gains. The department identified the error early in fiscal year 2006-07, and appropriately recorded a prior year transaction to correct the error. The correction attributes for $23,601,751 of the amount shown prior year revenues and transfers-in adjustments on the Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2007, in the Permanent Fund.

8. Contingencies

PPL Montana, LLC v. State of Montana: In June 2008, the court decided in favor of the state, ordering PPL Montana, LLC to pay $40,956,180 in rent for hydroelectric dams located on state-owned riverbeds. The decision recognizes rent from year 2000 through 2007, the time period PPL Montana owned and operated the dams. The decision is expected to be appealed.

Department of Natural Resources and Conservation

Department Response

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION

BRIAN SCHWEITZER, GOVERNOR

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DNRC RESPONSE TO FY 07/08 LEGISLATIVE AUDIT

1) **We recommend the Department enhance, document, implement, monitor, and test internal controls, as required by state accounting policy.**

Concur: The Department will review state account policy and work to improve internal control protocols.

2) **We recommend the department ensure procurement policies and procedures are applied to equipment transactions for fire activities.**

Concur: The Department is restructuring fire finance and procurement business processes. This will ensure procurement policies and procedures are applied to equipment transactions for fire suppression.

3) **We recommend the department:**

A. Ensure equipment lease rates are limited to rates allowed by department policy.

Concur: The Department will review lease rates for fire suppression equipment; revise as necessary; and adhere to rates established in policy.

B. Establish procedures to ensure claims for fire costs include all documentation required by department policy prior to paying the claims.

Concur: The Department's restructuring of fire finance and procurement business processes will ensure claims include all documentation before processing.

C. Seek an alternative funding source for the $119,205 inappropriately charged to the state's general fund and emergency appropriations.

Do Not Concur: Although the ATV transactions were unsupported by "resource order" documentation, the Department believes the expenditure was reasonable and prudent due to the extreme fire conditions of the summer of 2007. The vehicles were invaluable to the fire suppression efforts in Western Montana.

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LEGISLATIVE AUDIT DIV.

4) **We recommend the department establish procedures to ensure meal costs are reimbursed at rates allowed by state law for employees in travel status.**

Concur: The Department will work with the Department of Administration to clarify fire fighter meals with caloric intake requirements, and in general, providing meals for emergency operations. As necessary, the Department will amend its policy on meals, and ensure its implementation.

5) **We recommend the department discontinue paying for unallowable or unsupported expenditures charged to fires.**

Concur: The Department's restructuring of fire finance and procurement business processes will ensure the review and certification of claims charged to fire suppression.

6) **We recommend the department:**
A. Continue to maintain expenditure records in sufficient detail to identify the administration costs incurred for the benefit of each trust.

Concur.

B. Seek a change in legislation to establish an expenditure allocation method that results in reasonable and appropriate cost allocations to each individual trust.

Concur. LC0283 has been approved by EQC for bill drafting.

C. Repay $1,543,494 inappropriately withheld from Common School, State Reform School, MSU-Morrill, MSU-second grant, and Montana School for the Deaf and Blind trust revenues to the trusts and their beneficiaries.

Do not concur.

If DNRC were to implement the new methods described herein to account for administrative expenses, maximum expenditure caps established in 77-1-109, MCA for FY07 would be exceeded for the following trusts: University of Montana, State Normal School, School for the Deaf & Blind, the Veterans Home, and Capitol Buildings. If new methods were implemented in FY08, expenditure caps in 77-1-109, MCA would be exceeded for the following trusts: State Normal School, the Veterans Home, and Capitol Buildings. In order to fully implement new methodologies discussed in this report, the division believes that additional changes to present law would be needed, consistent with LAD Recommendations #6B and #7B from the 2008 Audit. In the meantime, the department intends to continue to comply with Audit Recommendations 6A and 6B in order to continue to evaluate trends in cost accounting and to refine proposed methods aimed at improving accuracy of cost accounting by trust.

In the 2006 Audit, Recommendation #4 of the DNRC Financial Compliance Audit expressed the following recommendations to the Trust Land Management Division (TLMD):

A. Maintain expenditure records in sufficient detail to identify the administration costs incurred for the benefit of each trust, and

B. Evaluate the expenditure data to ensure each land trust's administration charges are reasonable and, if necessary, develop another allocation method that results in reasonable charges.

DNRC complied with Recommendations #4A and #4B as noted in the 2008 Audit. The Trust Land Management Division program managers have reviewed revenue data, expenditures, and activities for fiscal years 2007 and 2008 and have developed alternate methods to account for costs by trust. As discussed in the audit, current accounting methods assign costs by trusts as a percentage of revenue earned by a trust in a year. While the alternate methods vary slightly by program, the overall premise is to account for expenditures based on activity or work completed on a trust in a fiscal year and measured by the amount of acres managed by trust by program. It is too early to state definitively that these new methods are "better" or more "accurate" than previous methods of assigning costs by revenue; however, with different methods come different results.

Current funding mechanisms limit the division's ability to charge management costs to a trust when those costs exceed statutory caps. Present law currently establishes seven different accounts utilized to fund administrative expenses incurred in the management of state trust lands, each with its own limitations and authorities (Legislative Audit Division, DNRC Financial Compliance Audit, October 2008, p. 16). The Auditor identified limitations in 77-1-109, MCA, including the potential for actual costs to exceed expenditure caps authorized in statute. Similar statutory limitations exist within 77-1-607, MCA, wherein no more than 3% of income can be deducted from leasing activities for the improvement and development of state lands.

7) We recommend the department:
A. Refrain from charging any trust fund an amount in excess of that allowed by law.

Concur.

B. Seek legislation to establish a mechanism for funding the Trust Land Administration Account when initial allocations exceed the maximum deposit amounts allowed by state law.

Concur. LC0283 has been approved by EQC for bill drafting.

8) **We recommend the department maximize trust revenues as required by their fiduciary duty to the trust by:**

A. Leasing property acquired under the Eustance Ranch transaction to the fullest extent possible.

Concur. The department will pursue issuing a grazing license on the proposed easement area if it is determined that a license will not create impacts to the historical or cultural properties located on the lands.

B. Ensuring fair market value is reflected in the final easement transaction with the Department of Fish Wildlife and Parks.

Partially concur. In 2007 the Department purchased 897.82 acres from John and Marilyn Eustance for $800 per acre. The appraised value for the property was $1,080 per acre. The Land Board approved the disposition of an interest in state land for park purposes to DFWP for $800 per acre, which was the same price that DNRC paid for the land, but was $280 less per acre than the appraised value. The Department will approach DFWP and the Land Board to ascertain their interest in revisiting the option agreement between DNRC and DFWP that was previously approved and signed by all parties.

9) **We recommend the department implement procedures to ensure all information regarding land banking transactions is communicated to those responsible for recording the activity on the state's accounting records.**

Concur. The Trust Land Management Division will develop procedures for land banking acquisitions that will provide details of the transaction. Additionally, a form will be developed to include the purchase price of the property, appraised price, monetary donations from other entities and donations and or seller, by trust beneficiary. This form will be provided to the Centralized Services Division along with a copy of the purchase agreement and the title company settlement/closing sheet.

10) **We recommend the department capitalize the remaining $50,500 in lease payments as required by state law.**

Concur: The Department is in the process of capitalizing the full lease payment on equipment. A Budget Change Document is required and the transactions should be complete by the end of October 2008.

11) **We recommend the department establish procedures to ensure property donated from the federal Department of Defense is recorded in accordance with state law and policy.**

Concur: The Department has developed procedures to reflect the fair market value of equipment donated from the federal Department of Defense.

12) **We recommend the Department deposit revenue from the sale of public land to the permanent fund, as required by the Enabling Act.**

Concur: The revenue correction discussed in the report has been completed on Journal #1680832.

13) **We recommend the Department:**
A. Record its fiduciary activities appropriately on the state's accounting records as required by state law and policy.

Concur. The Department will work with the Department of Administration in recording cash and cash equivalent sureties, including certificates of deposit, as property held in trust within the proper fund.

B. Deposit all bid receipts as required by state law.

Concur. For bid receipts typically held for 30 days or less, the department will request a modified deposit schedule as provided under §17-6-105 (8)(a), MCA, and in 2-1210.23 & 2-1190.35 of volume II of the Montana Operations Manual. The department will deposit all bid receipts that are held because the lease rate and lessee are being contested under 36.25.117(8), ARM.

14) **We recommend the Department:**
A. Implement procedures to ensure the results of litigation are considered during the fiscal year-end process in accordance with state law and policy.

Concur: This procedure has been added to fiscal year-end requirements and discussions between fiscal bureau and legal will occur each June.

B. Record transactions to properly reflect the $41 million settlement in accordance with state law and policy.

Concur: The transaction has been recorded on Journal #1739082.

15) **We recommend the Department:**
A. Invest funds only when authorized to do so under state law.

Concur

B. Repay the general fund the $23,198 for earnings the department was not authorized to retain.

Concur: The repayment has been processed on Journal #1741770.

16) **We recommend the department recover indirect costs to the fullest extent possible, as required by state law.**

Partially Concur: The Department concurs with the recommendation as written and has recovered indirect costs to the fullest extent possible. Following the 2000 fire season, attempts to recover indirect costs from FEMA were denied. Fire suppression activity is excluded within the Departments indirect cost recovery model due to the extreme swing in activity. Therefore, fire costs are not reflected in the annual Department's federally approved indirect rate, and not an allowable charge to FEMA. The Department will however, re-evaluate its indirect cost methodology.

17) **We recommend the department document compliance with federal requirements that prohibit contracting with suspended and debarred parties.**

Concur: The Department currently verifies contractors are not listed as suspended or debarred, however, had not documented the process. The Procurement and Contracting Bureau has instigated a signature check-off documenting the process.